

Internal Revenue Service
Appeals Office
4050 Alpha Road
Suite 517, MC:8000NWSAT
Dallas, TX 75244

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

AP:FE:DAL:

In Re:

EO Revocation

Form Required to be Filed:

1120

Tax Period(s) Ended:

**Last Date for Filing a Petition with
the United States Tax Court:**

Release Number: **200940033**
Release Date: 10/2/09
Date: May 21, 2009

UIL Code: 501.03-30

Certified Mail

Dear _____

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January x , xxxx.

Our adverse determination was made for the following reason(s): A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance, you rely on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated for a substantial nonexempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in section 501(c)(3).

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

TEAM MANAGER



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
TE/GE Examinations

March 21, 2007

Legend
ORG= Name of organization
EIN= EIN of organization

ORG

Taxpayer Identification Number:

EIN

Form:

Tax Year(s) Ended:

December xx, 20XX

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

Letter 3618 (04-2002)
Catalog Number 34809F

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Rameriz
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer CC		Year/Period Ended 12/xx/20XX

LEGEND

AA= State	SS= Related organization
AB= County	XX= Year
CC= Name of organization	xx= Date
NN= Name of Individual	x= Amount

Issue:

Whether CC operated exclusively for exempt purposes within meaning of Internal Revenue Code section 501(c)(3)?

Facts:

CC is a AA not-for-profit corporation, incorporated on May xx, 19XX. The stated purpose of the corporation is to acquire and administer funds and property which, after the payment of necessary expenses, shall be devoted exclusively to religious, charitable, scientific, literary or educational purposes.

On May xx, 19XX, CC applied for recognition as a tax-exempt organization described in section 501(c)(3) on Form 1023. On December xx, 19XX, based on the information that CC provided in its application for exemption, and on the assumption that they would operate in the manner represented in its application, CC was recognized, as of May xx, 19XX, as a tax-exempt organization described in section 501(c)(3).

Since 19XX, CC, has promoted and operated a Down Payment Assistance program (hereinafter "DPA") under which it provides funds to home buyers to use as their down payments and collects the same amounts, plus additional fees, from the home sellers. As more fully described below, under CC's program, down payment assistance is provided for all types of housing loan programs, including federally insured mortgages, to buyers, whether first time or not, and without any income or asset limitations. The marketing activities of CC, include distributing pamphlets and providing information on its web site. Its pamphlets state that CC, works with mortgage lenders and realtors nationwide to offer its down payment assistance program. The web site provides a link for online processing, a list of participating mortgage lenders, and a copy of the pamphlet.

Application for Recognition of Tax-Exempt Status:

CC filed Form 1023, Application for Recognition of Exempt Status, with the IRS under penalties of perjury on May xx, 19XX, in which it represented its activities to be as follows:

The primary activity of the CC (the "Corporation") is to assist low income families with the purchase of a home.

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Specifically, the officers of the Corporation will first hold free counseling seminars to educate members of the general public about the home buying process. The seminars will address the following:

- how to determine the amount you can afford when buying a home
- debt to credit ratios and formulas
- property taxes, interest calculations and insurance cost
- home inspections
- real estate purchase documents
- the loan process and loan documents
- the underwriting process and underwriting documents
- the homestead exemption and application process
- legal aspects of buying and owning a home
- tax benefits of owning a home
- equity appreciation

After attending the free seminar, an individual will receive a Certificate of Completion confirming his/her attendance.

Individuals who complete the seminar, receive a Certificate of Completion and who also qualify for assistance under FHA guidelines may then apply for aid from the Corporation. The applicants will be charged a nonrefundable xx fee which will be applied to the Corporation's processing costs. Upon receipt of an application, the Corporation will first verify the applicant qualifies for assistance under FHA ratio guidelines. Provided the applicant meets the FHA qualification requirements, and other general loan requirements (credit, complete information provided, etc.), then the applicant will be issued preliminary approval for gift funds from the Corporation, which funds will be used for the down payment on a home for the applicant. Provided the remaining requirements (set forth herein below) are met, the Corporation will give the applicant, at the closing of the home purchase, funds equal to 3% of the purchase price to be used only for the down payment towards the purchase of the home. Applicant will not be required to repay these funds to the Corporation.

In addition, the Corporation will assist the applicant in finding a lender willing to fund the remaining purchase price for applicant via an FHA or conventional loan. To participate in the Corporation's loan program, the lender must agree to include the majority of closing costs into the loan, and the total loan must be within the financial guidelines for which the applicant has qualified. In other words, the total loan and repayment terms must be within the range applicant can afford using FHA and general lending ratios.

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In order to receive the gift funds, the applicant must procure a contract for the purchase of a home within the price range for which the applicant has qualified. The contract must also be made with a Seller who has agreed in the contract to the Corporation's requirements. Specifically, the Seller must agree in the contract to furnish the applicant with a one year home warranty at no cost to the applicant, and the Seller must agree to pay Corporation x% of the purchase price at the closing of the sale. Fees received, after reduction for operational costs is [sic] used to grant further charitable gifts and provide continued counseling for the general public.

In addition, CC requires the applicant to provide his/her own funds for a Home Owner's Insurance policy with an insurer of applicant's choice, as well as pre-paid taxes and insurance.

Real Estate agents who wish to participate in CC's programs must provide CC with a written application setting forth the agent's license information, employment and references. A nonrefundable xx fee is charged to the agent by CC to process the application by verifying the credentials listed.

The rationale underlying the Corporation's charitable purpose is basically that CC promotes stability. Revitalized neighborhoods make a tremendous difference in families owning rather than renting. Many low income families, even with reasonably good credit, are unable to purchase their own homes. Most lack the down payment and closing cost. Not all persons are fortunate enough to have family or friends who can contribute to their well being. The Corporation's goal is to help these types of families to own a home, thereby promoting stable communities.

According to form 1023 the source of financial support for CC will be as follows in order of size:

- Fees collected from sellers of residential real estate at closing of the sale
- Application processing fees from applicants
- Processing fees paid to corporation by real estate agents to verify agent is licensed and active

The requested information and responses were as follows:

1. Requested information: Please submit a copy of the FHA income qualification guidelines.

Response: "The maximum FHA loan available for buyers in AB (location of the organization) is \$XXX. FHA Income Qualifications are determined by ratios of 29/41. The mortgage payment must be less than xx% of the applicants' monthly total gross income. Additionally, the applicants' combined mortgage payment and installment debt may not exceed xx% of gross monthly income.

2. Requested information: You list compensation for NN as \$XXX for 19XX, \$XXX for

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20XX and XXX for 20XX, please submit a brief explanation as to the significant increases in her salary each year.

Response: "The Corporation may be unable to pay NN compensation of \$XXX in the initial years. It will take considerable time and effort to reach the organization's goal of providing down payment gift funds for thirty applicants monthly. The proposed budget reflects a reasonable amount of time to obtain this goal.

3. Requested information: if you require the seller to pay the organization x% of the purchase price, how is the real estate agent then paid?

Response: "The real estate agent is paid by the seller at the close of escrow. The agreement between the seller and agent is separate and apart from the agreement with the organization. The organization provides the seller the benefit of a larger percentage of potential buyers. The seller's fee to the organization is paid only if the buyer has received a Certificate of Completion of CC counseling and receives an assisted down-payment from the organization. The seller is not limited in any way from continuing to offer their home to other potential buyers."

4. Requested information: You have \$XXX listed as "Gross Investment Income" for 19XX and then have an expense listed for 20XX and 20XX of repayment of gross investment income, please fully explain both of these items.

Response: "The capitalization of the organization is shown as item 3. Gross Investment Income. This start-up capital is to be repaid interest only x% for six month (Shown as item 19. Interest). After six months, the \$XXX principal and interest at x% is to be amortized and fully repaid in thirty six months; \$XXX monthly (shown as Item 22. Other). (Schedule "D")."

5. Requested information: In my letter dated June xx, 19XX, I requested a copy of the FHA income qualifications guidelines used by the organization, you submitted a copy of FHA's maximum mortgage limits. Please submit a copy of the income qualifications used by the FHA to qualify for an FHA loan, for example \$xxx maximum annual income for a family of x.

Response: "The x% loan program does not specify Income Qualifications. Instead, FHA controls the Maximum Loan Amount available to the Buyer based upon what a low to moderate income family can afford to pay for housing. Additional, FHA requires the Buyer to meet certain Debt to Income ratios."

6. Requested information: Based upon our review of your Form 1023 and additional information, it appears that you operate in a manner similar to a real estate broker and/or agent, i.e. you bring buyers and sellers of the homes together through your programs that result in a home sale. Please submit a detail explanation regarding how your business differs from any other for profit real estate brokerage and/or agency.

Response: "CC serves the general public by offering the following:

1. Education: A Division of the Organization, SS, will provide Educational

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Counseling with regards to homeownership. Many participants will be first time home buyers, single parents with children to support, minorities, and/or persons who have reasonably good credit but just haven't been able to acquire a down payment from their income.

2. Down Payment Assistance: FHA encourages community CC by allowing close family members, or a charitable organization, to contribute as a gift the Buyer's 3% down payment.

3. Protection for Home Buyers: CC requires the Buyer to obtain a professional Home Inspection and the Sellers to provide a one-year Home Buyers Warranty.

Unlike a Real Estate Agency, CC does not assist the Buyer in locating a home, bringing a buyer and seller together, preparing the offer, negotiating the terms, providing information to the lender, not attend the Buyer's closing."

7. Requested information: Why would the seller want to pay the real estate agent a commission and also pay the organization x% commission? What benefits does the seller receive in exchange for participating in the program?

Response: "The seller does not directly participate in the program(Education and Down Payment Assistance) rather, the Seller may accept or reject the Buyer's offer which includes a x% service fee, payable at closing, to CC The Sellers may refuse the offer and continue to market their home or choose the Benefit of selling their home more quickly as they now have educated and qualified Buyers ready, willing and able to purchase their home.

The original 1023 application provided by CC disclosed that the sources of financial support would be from fees collected from sellers of residential real estate at closing of the sale, the application process fees from applicants, and processing fees paid by real estate agents. The application also explained that the percentage that the organization would receive from the seller at closing would be x%. It also states that the fees received, after reduction for operational cost, are used to grant further charitable gifts and provide continued counseling the general public. The application does not state, however, that the fees collected from the sellers are earmarked for specific buyers at closing.

Articles of Incorporation:

The Articles of Incorporation for CC dated March xx, 19XX state the following:

Article II: The corporation is organized pursuant to the provisions of the AA Nonprofit Corporation Code(the "Code").

Article III: The objects and purposes of the Corporation are to acquire and administer funds and property which, after the payment of necessary expenses, shall be devoted exclusively to religious, charitable, scientific, literary, or educational purposes.

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The Articles of Incorporation of CC include a dissolution clause which requires that, upon dissolution, remaining net assets will go to another 501(c)(3) organization.

Federal Returns:

CC filed Forms 990 for the calendar years ended December xx, 20XX and 20XX; it did not file Forms 990-T. The organization reported the income from the fees paid by the sellers as contributions. The service charge was reported as program service income.

Part III, statement 4, of CC Form 990 for the 20XX tax year states, "Individuals who qualify for assistance under FHA guidelines may apply for aid from CC. At the Closing of the Home purchase, funds equal to x% of the purchase price will be given to be applied toward the down payment of the home. These funds are not required to be repaid".

In 20XX CC received \$XXX in gross revenue from amounts paid to it by sellers participating in CC DPA program. CC reported the sellers' payments as contributions and the service charge was reported as program service revenue. CC also reported that it distributed \$XXX in down payment assistance to homebuyers for use as down payments and/or to pay for closing costs. CC's form 990, Part IV, line 73 shows that as of December xx, 20XX, CC had total unrestricted/net assets of -\$XXX.

Operation of CC Down Payment Assistance Program:

CC advertised in its publication the process through which an applicant may receive down payment assistance. The publication stated that the organization offers potential homebuyers a nationwide down payment assistance program that has helped many people to purchase a home. The publication also disclosed that there were no income restrictions, first time buyer status, or educational requirements. The publication stated that the organization gives a potential applicant up to x% of the sale price of the house to be used as a down payment or for closing costs. The publication also stated that the funds are a "gift" to the potential home buyer from a non-profit charitable organization. The funds are not required to be repaid. The publication also states the seller makes a contribution to CC to cover the amount of the gift plus a small service fee.

The organization works with mortgage lenders and realtors nationwide to offer the program. The mortgage lenders will help to determine whether the potential home buyer is qualified for the program.

CC does not provide down payment assistance to the buyer if the seller does not enter into the agreement with CC, the buyer, and the real estate agent. If the seller agrees to participate, the agent and buyer proceed to try to get the buyer approved for a loan through a mortgage company which will accept gift funds from a 501(c)(3) organization. CC, provides the lender with a Certificate of Completion to advise the lender of the amount of the "gift funds" the buyer will receive. When the loan is approved, the organization is notified and the closing attorney sends to

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CC wiring instructions. CC wires the promised amount of down payment upon the closing of the sale.

The seller wires or delivers the downpayment assistance and the x% service fee to the closing attorney (the money is not given directly to CC by the seller). The check is made out to the closing attorney and is deposited into an escrow account. After closing, the funds are wired to the organization by the attorney. .

If the sale is not completed, the seller provides no funds to CC. There is no evidence that CC, ever provided any down payment assistance to a buyer of property the seller of which did not reimburse CC, for the amount of the down payment assistance provided, plus the administrative fee.

CC, does not have any income limitations for its DPA program and did not screen applicants for down payment assistance based on income. The records provided by CC, did not include data on the buyers' incomes and gave no indication that CC screened with respect to such data. CC's DPA program provided down payment assistance to any homebuyers who qualified for a mortgage loan.

According to the Form 1023 application provided by CC and subsequent correspondence with the IRS, FHA income qualifications are determined by ratios of 29/41 which means that the mortgage payment must be less than x% of the applicant's monthly total gross income. The applicant's combined mortgage payment and installment debt may not exceed x% of applicant's gross monthly income. There is no income limit for the program.

In essence, these transactions result in a circular flow of the money. The sellers make payments to CC provides funds to the buyers; the buyers, in turn, use the funds to make the down payment necessary to purchase the home from the seller.

Law & Argument

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings of such corporations inures to the benefit of any private shareholder or individual. See I.R.C. § 501(c)(3).

Treasury Regulation section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . .

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[nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes.”

Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Treasury Regulation section 1.501(c)(3)-1(d)(2) defines the term “charitable” for section 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term “charitable” also includes the advancement of education.

Treasury Regulation section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term “educational” for section 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Treasury Regulation section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of section 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization’s primary purpose does not consist of carrying on an unrelated trade or business.

In Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), aff’d, 846 F. 2d 78 (Fed. Cir.), the U.S. Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under section 501(c)(3). The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization’s argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization’s operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization’s sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman’s child sponsored the care financially. Accordingly, the court found that the “business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff’s adoption service is its primary goal” and held that the organization was not operated exclusively for purposes described in section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

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In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in section 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner." American Campaign Academy, 92 T.C. at 1077.

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of section 501(c)(3). The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence collected by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from communities of craftsmen. The organization did not market the kind of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged. The court concluded that the overall purpose of the organization's activity was to benefit disadvantaged communities. The organization's commercial activity was not an end in itself but the means through which the organization pursued its charitable goals. The method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in § 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D. D.C. 2003), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

Among the major factors courts have considered in assessing commerciality are competition with for-profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors

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include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations.

See also, Living Faith Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for substantial commercial purposes and not for exclusively exempt purposes).

Revenue Ruling 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is a "charitable" activity because it relieves the poor and distressed or underprivileged. In Revenue Ruling 67-138, the organization carried on several activities directed toward assisting low-income families to obtain improved housing, including (1) conducting a training course on various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Revenue Ruling 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of section 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of section 501(c)(3).

Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was lower than in other sections of the city and the housing in the area generally was old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area, sponsored a renewal project, and involved residents in the area renewal plan. The organization also purchased an apartment building that it rehabilitated and rented at cost to low and moderate income families with a preference

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given to residents of the area. The revenue ruling held that the organization was described in section 501(c)(3) because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption under section 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of section 501(c)(3) and the Treasury regulations.

Revenue Ruling 2006-27, 2006-21 C.B. 915, discussed whether organizations that provide DPA operate exclusively for charitable purposes. Situation 2 described an organization formed to provide down payment assistance to low-income persons. In deciding whether to provide assistance to a low-income applicant, the organization's grantmaking staff knew the identity of the home seller and also potentially knew the identities of other interested parties. Thus, the organization's grantmaking staff was able to take into account whether the home seller or another interested party was willing to make a payment to the organization. To finance its DPA activities, the organization relied on payments from sellers and other real-estate related businesses that stood to benefit from the transactions that the organization facilitated. In substantially all of the transactions, the organization received a payment from the home seller corresponding to the amount of the down payment assistance provided on the seller's home. The Revenue Ruling held that the correlation between the amount of the seller's payment and the amount of the down payment assistance provided on the seller's home, and the organization's reliance on the sellers' payments for most of its funding indicated that the benefit to the home sellers was a critical aspect of the organization's operations. In this respect, the organization was like the organization considered in Easter House, which received all of its support from fees charged to adoptive parents. Like the organization considered in American Campaign Academy, the organization was structured and operated to assist private parties who stood to benefit from its operations. The Revenue Ruling concluded that the organization was not operated exclusively for exempt purposes and, thus, did not qualify for exemption from federal income tax as an organization described in section 501(c)(3).

Benefiting Private Interests:

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of section 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1).

Revenue Ruling 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) because it gave preference to employees of a business operated by the individual who also controlled the organization. The

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ruling reasoned that, although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 166 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of KJ's Place, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of KJ's Place. The organization derived most of its funds from its lottery ticket sales. The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations.

The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of KJ's activities was to benefit KJ's place and its owners by attracting new patrons, by way of lottery ticket sales, to KJ's Place, and by discouraging existing customers from abandoning KJ's Place in favor of other lounges where such tickets were available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

Effective date of revocation:

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 2003-4, §14.01 (cross-referencing §13.01 et seq.), 2003-1 C.B. 123. An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents. In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, §13.02, 1990-1 C.B. 514.

The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01 (cross-referencing § 13.01 et seq.).

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Analysis:

CC is not described in section 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3), and (2) provides substantial private benefit to persons who do not belong to a charitable class.

Charitable purposes include relief of the poor and distressed. See Treas. Reg. § 1.501(c)(3)-1(d)(2). CC's down payment assistance program does not operate in a manner that establishes that its primary purpose is to address the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1. The down payment assistance program does not serve exclusively low-income persons. CC does not have any income limitations for participation in its DPA program. CC does not screen applicants for down payment assistance based on income. CC records do not include data on the buyers' incomes. Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. The program is not limited to first-time homebuyers. Assisting random individuals in obtaining mortgage loans does not relieve the poor and distressed within the meaning of section 501(c)(3).

CC program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3) of the Code.

Although CC purports to provide some homebuyer counseling, the record does not establish that this activity was substantial. Moreover, even if substantial, this activity was outweighed by activities that served substantial non-exempt purposes.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if the DPA program were directed to exclusively low-income individuals or disadvantaged communities, CC's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), CC is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in CC's program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market. They also benefit by being able to sell homes at the full listed prices or by being able to reduce the amount of the negotiated discounts on the homes. Buyers who participate in CC's program

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benefit by being able to purchase a home without having to commit more of their own funds. Real estate professionals who participate in CC's program, from real estate brokers to escrow companies, benefit from increased sales volume. It is evident from the foregoing that CC program provides ample private benefit to the various parties in each home sale.

CC's down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, CC relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates. CC neither solicits nor receives funds from other sources. Before providing down payment assistance, CC's staff takes into account whether there is a home seller willing to make a payment to cover the down payment assistance the applicant has requested. CC requires the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller's home, plus an administrative fee of x% of the sales price per home sale. CC secures an agreement from the seller stipulating to this arrangement prior to the closing. No DPA assistance transactions take place unless CC is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing. CC's instructions to title and escrow companies provide that at the close of escrow the seller's contribution, along with any CC's fees, must be sent to CC after closing. The fact that the service fees charged the sellers in each instance were calculated to reimburse CC for the cost of providing down payment assistance on the seller's home, as well as CC's total reliance on seller fees and fees from real estate professionals for support indicate that the private benefit to home sellers was a critical aspect of CC's operations.

CC's promotional material and its marketing activities show that CC, operated in a manner consistent with a commercial firm seeking to maximize sales of services, rather than in a manner that would be consistent with a charitable or educational organization seeking to serve one or more of the charitable purposes enumerated in § 501(c)(3). The manner in which CC operated its DPA program shows that CC was in the business of facilitating the sales of homes in a manner indistinguishable from an ordinary trade or business. In this respect CC's operations were similar to an organization which was denied exemption because it operated a conference center for commercial purposes. See Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003).

Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), CC's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. CC provided services to home sellers for which it charged a market rate fee. CC did not market its services primarily to persons within a charitable class. CC's primary goal consisted of maximizing the fees it derived from facilitating the sales of real property. CC did not solicit or receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in American Campaign Academy and Easter House, a substantial part of CC's activities furthered commercial rather than exempt purposes.

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Based on the foregoing, CC has not operated exclusively for exempt purposes, and, accordingly, is not entitled to exemption from federal income tax as an organization described in section 501(c)(3).

Furthermore, the payments from the home sellers to CC also do not qualify as gifts under section 102. The payments from the home sellers do not proceed from detached and disinterested generosity but, rather, are in response to an anticipated economic benefit, namely facilitating the sale of the seller's home. Under Commissioner v. Duberstein, 363 U.S. 278 (1960), such payments are not gifts for purposes of section 102.

The government proposes revoking CC's exemption back to January x, 20XX. In its application for exemption signed under penalties of perjury on May xx, 19XX, CC represented that its purpose was to "assist low income families with the purchase of a home." The records provided by CC did not include data on the buyers' incomes and gave no indication that CC screened with respect to such data. Rather, CC's DPA program provided down payment assistance to any homebuyers who qualified for a loan. Furthermore, although CC stated that it provided counseling to home buyers, no contemporaneous records were kept to verify the number of persons counseled or the type of counseling provided. Revocation of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 2003-4, § 14.01. CC's operation of its DPA activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of CC's determination letter.

Conclusion:

In order to qualify for exemption under section 501(c)(3), an organization must be both organized and operated to achieve a purpose that is described under that Code section. CC is not operated in accordance with Internal Revenue Code section 501(c)(3) and the regulations thereunder governing qualification for tax exemption under the Code. CC provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home. CC offers its down payment assistance to interested buyers regardless of the buyers' income levels or needs. CC's activities do not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination.

CC operates in a manner indistinguishable from a commercial enterprise. CC's primary activity is brokering transactions to facilitate the selling of homes. CC's primary goal is to maximize the fees from these transactions. CC's brokering services are marketed to homebuyers, sellers, realtors, lenders, home builders, and title companies regardless of the buyers' income level or need and regardless of the condition of the community in which the home is located. Because CC's primary activity is not conducted in a manner designed to further section 501(c)(3) purposes, CC, Inc is not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

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For the foregoing reasons, revocation of exempt status is proposed, effective January x, 20XX.

Taxpayer's Position:

CC was offered a supervisory conference after the laws, issues facts and conclusions were discussed. NN, President of the organization, stated she did not feel the need to have a conference with the supervisor. She also stated that she would probably appeal but will first have to consult with her attorney before she gives an official statement about the outcome.